

MINUTES

MONTANA SENATE 58th LEGISLATURE - REGULAR SESSION

COMMITTEE ON ENERGY AND TELECOMMUNICATIONS

Call to Order: By **CHAIRMAN ROYAL JOHNSON**, on January 30, 2003 at 3:00 P.M., in Room 317-B & C Capitol.

ROLL CALL

Members Present:

Sen. Royal Johnson, Chairman (R)
Sen. Corey Stapleton, Vice Chairman (R)
Sen. Bea McCarthy (D)
Sen. Walter McNutt (R)
Sen. Gary L. Perry (R)
Sen. Don Ryan (D)
Sen. Emily Stonington (D)
Sen. Bob Story Jr. (R)
Sen. Mike Taylor (R)
Sen. Ken Toole (D)

Members Excused: None.

Members Absent: None.

Staff Present: Todd Everts, Legislative Services Division
Marion Mood, Committee Secretary

Please Note. These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:

Hearing & Date Posted: SB 247, 1/24/2003
Executive Action: none

HEARING ON SB 247

Sponsor: SEN. JOHN COBB, SD 25, AUGUSTA

Proponents: John Fitzpatrick, NorthWestern Energy
John Hines, NW Power Planning Council

Opponents: **Bob Rowe, Public Service Commission (PSC)**
 Tom Schneider, PSC, self
 Bob Nelson, Consumer Counsel
 Patrick Judge, MEIC
 Susan Good, self

Opening Statement by Sponsor:

SEN. JOHN COBB, SD 25, AUGUSTA, stated SB 247 directs the Public Service Commission (PSC) to pre-approve procurement of electricity by the default supplier who must develop a plan designed to satisfy commission rules; and it establishes up front achievable standards by which the eligibility for rate recovery will be known by the default supplier prior to the execution of a power supply contract. The sponsor explained different sections of the bill, concluding that it was necessary to put in statute what heretofore had been mere guidelines. He felt pre-approval provided a better chance for the construction of new generation plants because it removed the uncertainty which would affect the ability to obtain financing. He told the committee that opponents will complain this provision will shift the cost to the consumer but he felt it protected the consumer by ensuring long-term, stable contracts at cheaper rates. He also stated that the default supplier faced more risk now than he did when the utility had a monopoly, and thus the reason for the bill.

Proponents' Testimony:

John Fitzpatrick, NorthWestern Energy, expressed his company's appreciation to the sponsor for bringing SB 247 forward and endorsing the concept of pre-approval. He strongly believed pre-approval was essential to ensure the financial integrity of the company acting as the default supplier, and it was important for the customers because it allowed for securement of long-term contracts at lower prices. He stressed there was a lot of uncertainty in the financial markets for electric utilities which he felt was related to the upheavals of 2000/2001 in California and which was still forcing major utilities into bankruptcy (Pacific Gas & Electric). He pointed to market manipulation by companies such as Enron, and major companies moth-balling plans for new generation because of the difficulties they faced in obtaining financing. The certainty which existed in the utility industry for many years was gone, and people were looking to the industry for certainty and secure investments; this process would be enhanced by the concept of pre-approval. He told the committee that over the past few months, NorthWestern Energy, along with other parties, had participated in a forum at the PSC to work on procurement guidelines for the default supply and felt this had been a positive, albeit unofficial, dialogue which

helped clarify some of the existing uncertainty surrounding the default portfolio process. In the end, though, it was not cost recovery and still fell short of the certainty the company needed to procure energy supplies. Adopting pre-approval removed the risk for a company going forward and signing a contract. To illustrate his concerns, he handed out **EXHIBIT(ens20a01)**, a comparison of electric procurement, both with and without pre-approval. The second page shows three different scenarios: the first is likely to be approved by the PSC and the second would probably be rejected as being too high. The problem was with the third case because it was anybody's guess what future prices would be, and if the PSC thought it was unreasonably high, they could very well disallow a percentage of the cost which would result in a huge liability to the company as they could not recover this cost in rates.

John Hines, Northwest Power Planning Council, praised the bill as it provided ratepayers greater stability in rates as well as low cost rates. He did not want to repeat previous testimony but touched briefly on the issues of risk shifting and customer protection. He maintained the PSC could either make their determination after the fact when all the information was available, or do it up front through pre-approval when the same wealth of information was available, in effect allowing the utility to go forward and enter into those contracts with assurance of recovery. He added that there still would be a prudence review regarding the administration of the contracts after the fact, and this would provide adequate customer protection. Secondly, he stated the risk paradigm has shifted; in the old days, risk was put squarely on the utility which was compensated by potential rate of return. He clarified that entering contracts represented pure expense, there was no rate of return or profit, only financial loss if a poor decision was made. He cautioned that this realization lends itself to seeking short-term contracts which lessens the utilities' risk should the PSC deem the contracts not prudent. A pre-approval process would allow the utility to enter into long-term contracts and/or contracts with new generation which is a necessary ingredient for affordable and stable rates. He reminded the committee of the volatility of the wholesale market as evidenced in the recent past and maintained there still were some fundamental imbalances. He predicted an upswing in the wholesale market in two to three years which made it all the more important to be able to secure long-term contracts.

Opponents' Testimony:

Bob Rowe, PSC, handed written testimony to the secretary, **EXHIBIT(ens20a02)**.

[Tape: 1; Side: B]

Tom Schneider, self, also provided written testimony,
EXHIBIT (ens20a03).

Bob Nelson, Consumer Counsel, listed the following five areas of concern: first, SB 247 shifts the risk to small consumers; secondly, the bill removes incentives for cost control; thirdly, it removes flexibility in an area where it is critical; fourth, it changes the PSC's role from regulator to manager, and finally, SB 247 was not needed as the PSC has been working successfully with regard to the issues contained therein. He felt the mechanics of the bill were not totally clear, and he stressed that his agency has historically opposed pre-approval for utility investments because the utility was in the best position to make decisions about resource procurement and cost control, and not the commission as it did not have the resources to duplicate a company's analysis. He was also concerned with the provision obligating the commission to select alternative resources and, at the same time, constraining the PSC to a plan they had not developed themselves. Lastly, he echoed previous sentiment in that SB 247 was not needed, saying if risk reduction was the primary concern, the committee should look to adopting the provisions in LC 1019(now HB 509) which he strongly supported.

Patrick Judge, MEIC, repeated the importance of long-term contracts in a utility's portfolio and agreed with previous testimony that the bill's concerns had already been addressed and were being met in other ways. His organization was in favor of procurement guidelines which are being referred to as "virtual pre-approval"; if a company followed those rules, it could be confident it would recover its costs.

Susan Good, self, stated in her many years as policy advisor to the PSC, seeing the procurement process up close showed her how much political pressure was exerted on the five elected officials. The demands made of them ranged from approving the building of new generation plants to pre-approving contracts and other ventures, with economic development and jobs in targeted areas the main concern. She felt the concept of pre-approval was dangerous because had the commissioners caved in to the pressure a few short years ago, the public would be facing much higher power prices. She lauded the previous, and current, commissioners for holding fast in their stance since otherwise, towns and communities would be pitted against each other in seeking to locate new power plants.

Informational Testimony:

Archie Nunn, Montana Senior Citizens Assn., professed his belief that the parties involved were left to deal with the aftermath of deregulation. While this was not fun for anyone, he implored the committee not to handcuff the PSC.

Questions from Committee Members and Responses:

SEN. GARY PERRY, SD 16, MANHATTAN, wondered if the commission's authority to pre-approve procurement agreements was in statute and SB 247 may not be needed. **Commissioner Rowe** replied the statute under which they were operating had been repealed, and thus the Legislature had to replace HB 474. He believed the standard by which the commission would review a portfolio as it was being assembled as well as its rule making authority were never disputed.

SEN. EMILY STONINGTON, SD 15, BOZEMAN, referred to a meeting of the Transition Advisory Committee (TAC) in Missoula at a time when the PSC was almost done formulating the procurement guidelines. Since he had labeled the bill's proposal as a "limiting prescriptive" process, she asked **Commissioner Rowe** how many of the guidelines were contained in this bill. **Commissioner Rowe** pointed to an attachment to his testimony which shows a list of areas where issues overlap and where they do not. The primary difference was that the PSC was a regulator who reviewed and focused on the process and not a utility manager, and he did not see the need for pre-approval at this point. **SEN. STONINGTON** recalled that at the same meeting, Pat Corcoran testified NorthWestern was very involved in developing the procurement guidelines. **Commissioner Rowe** confirmed this. **SEN. STONINGTON** stated these guidelines were being described as a virtual pre-approval and wondered what the difference was between "virtual" and "actual" pre-approval. **Commissioner Rowe** replied the basic point seemed to be an express contract-by-contract determination on every piece of the portfolio as opposed to looking at the whole process in determining its appropriateness. He did not favor the more aggressive approach.

SEN. KEN TOOLE, SD 27, HELENA, asked the commissioner to explain the rate of return issue.

{Tape: 2; Side: A}

Commissioner Rowe explained that in traditional rate making, the capital investment for serving customers is determined first. A rate of return is applied to the capital investment, and this is allowed to be depreciated; he charged there is no rate of return on the power contracts in the portfolio. He felt, since managing the portfolio was in itself a risky enterprise, this could be factored in when setting the rate of return on the capital investment. **SEN. TOOLE** asked what the rate of return had been

traditionally, and **Commissioner Rowe** estimated it to be about 10%.

SEN. BOB STORY, SD 12, PARK CITY, referred to the diagram **Mr. Fitzpatrick** had handed out and asked if it was an accurate portrayal of the two scenarios. **Commissioner Rowe** asked permission to check into this first. **SEN. STORY** wondered what the difference was between approval before and after a contract was signed since "on condition of approval" had not been acceptable in the past. **Commissioner Rowe** replied under current guidelines, the commission simply performed a review of the process while in accordance with the California approach, they would have to act as if they were in the manager's seat and remake all of the decisions; he repeated the PSC did not have the resources nor the personnel to do that. He preferred doing a process review and ensuring that contracts were being administered properly after the fact without being made to second-guess a contract. **SEN. STORY** asked why it was necessary to have a binding contract before the review as opposed to doing the review before closing the deal. **Commissioner Rowe** indicated he was speaking for himself when he said, with regard to some parts of the contract between MPC and Northwestern, there were questions as to the ability to perform and price, and his concern had to do with the fact those contracts were not signed. He felt **Mr. Nelson** might offer a different perspective. **SEN. STORY** wondered how the PSC would respond to the political pressure if the market turned during the approval process. **Commissioner Rowe** recalled they had faced a lot of political pressure just in the last month when they had to deal with the natural gas rate increase, and he charged the right thing to do had been to approve the increase. He believed the guidelines the PSC had prepared were more flexible and could better accommodate quick decision-making than the pre-approval process outlined in SB 247.

SEN. TOOLE outlined an example where, if the load was decreased due to an unforeseen alternative power supply and the utility was incurring a financial loss, would all of this risk then shift to the customer under SB 247. **Mr. Fitzpatrick** confirmed if a contract was in place and had been approved by the commission, this would be the case. **SEN. TOOLE** felt this would lessen a company's risk and take away their incentive for good management; therefore, he thought it appropriate if the commission held them to a lesser rate of return. **Mr. Fitzpatrick** did not think the company's desire or ability to manage risk would necessarily change due to this unforeseen situation, and as long as they continued to manage the transmission and distribution system in a responsible way, the PSC would not have any grounds to change anything.

CHAIRMAN JOHNSON, SD 5, BILLINGS, referred to the drafting of LC 1019 between NorthWestern Energy and the PSC and asked if he had been a part of that process, which **Mr. Fitzpatrick** confirmed.

CHAIRMAN JOHNSON inquired if the issue of pre-approval had come up during those talks. **Mr. Fitzpatrick** replied LC 1019 did include language with regard to commission review to ensure cost recovery but did not deal with the concept of pre-approval; he added it was modeled after HB 474. **CHAIRMAN JOHNSON** asked if he had tried to add the pre-approval concept to this bill. **Mr. Fitzpatrick** charged SB 247 was not requested by NorthWestern Energy even though they felt the concept of pre-approval merited discussion. He added even though he appeared as a proponent for SB 247, he felt it was an overly cumbersome bill and hoped it could be made workable with amendments by the various parties. His main interest was signing the contract before the company had to commit the money.

SEN. PERRY wondered if the sponsor was familiar with the contents of LC 1019, and **SEN. COBB** admitted he was not. **SEN. PERRY** went on to say he was confused by the testimony in **SEN. COBB's** SB 234 and SB 247 because in the former, the PSC claimed they already had the power he was trying to put into statute, and with the latter, the PSC claims it has the authority but does not want it in statute. **SEN. COBB** replied they were dealing with two different issues; SB 234 wanted to clarify the commission's authority, and with SB 247, he was asking the Legislature to decide whether the commission should be held to pre-approval.

SEN. MIKE TAYLOR, SD 37, PROCTOR, asked the sponsor if NorthWestern would be building a new power plant in Great Falls had there been pre-approval. **SEN. COBB** replied it would depend on the plan they presented to the PSC for pre-approval. **SEN. TAYLOR** re-directed his question to **Mr. Fitzpatrick** who explained NorthWestern had filed an application with the PSC to get an "exempt wholesale generator" status; this is a certification originating with Federal Energy Regulatory Commission (FERC) which states because these companies are affiliated, once this certification is given, they have the ability to have a contract between the affiliated parties. NorthWestern had told the commission should they be granted the certification, they would not consider it "pre-approval"; they would come back with the contract for their review in hopes of getting cost recovery. The PSC, however, argued this application should not be approved because in order for them to determine if the certificate would meet the test of being in the public interest, they needed to look at the financing. **Mr. Fitzpatrick** claimed without a contract, there would be no financing for the plant, and thus, no plant. He felt without some consensus in addressing this issue to the satisfaction of the PSC and the Consumer Counsel, the

plant in question would not be built. **SEN. TAYLOR** asked **Commissioner Rowe** what the PSC's commitment was to getting new power plants built without pre-approval as these companies needed to have certainty in taking the necessary steps. **Commissioner Rowe** replied under the theory of restructuring, under which they were still operating, generation is competitive in intra-state wholesale markets, and it does not require a permit or license from the PSC to build anything. The situation **Mr. Fitzpatrick** had described dealt with a particular requirement under the Federal Power Act where they had to obtain a certificate from FERC for the specific purpose of selling power from the generator affiliate back to their distribution company. FERC then has to check with the state commission for its recommendation. He charged the commission's decision was opposite of what **Mr. Fitzpatrick** had alluded to, namely that the staff had recommended a hearing on the application to the commissioners. Several of them had professed they did not see how this related to the Federal Power Act and the Public Utility Company Holding Act and thus asked NorthWestern to re-file the application to aid the commission in the determination whether the Federal Power Act requirements had been met. In his opinion, the commission could do several things to promote development of new resources, namely work on market rules to ensure any economically efficient resource can go forward with the focus on transmission system, policy, and pricing; secondly, he vowed to treat fairly anyone bidding a project into the portfolio by ensuring the rules are known beforehand. The third issue was to give NorthWestern strong direction and sufficiently reduced risk so that they may comfortably enter into long-term contracts. He stated the best thing the commission could do for economic development was to ensure that rates were stable, predictable, and relatively low. Lastly, he added the PP&L offer in 2001 resulted in a \$200 million infusion into Montana's economy, and he felt projects that made economic sense certainly should be allowed to go forward.

{Tape: 2; Side: B}

SEN. STORY asked if the default supplier's function was to be the most efficient representative of the small customer, why would anyone ever want to leave. **Commissioner Rowe** replied the original notion of default supply was a transitional or incidental function, and everyone would be purchasing power directly from the market. If this was the goal, then the default supply should not be the lowest price but somewhat above. Given the experience with direct retail access for small customers, he felt it was prudent to recognize the wholesale market is competitive, and small customers needed a representative to go into this market who would be as efficient as possible on their behalf.

SEN. DON RYAN, SD 22, GREAT FALLS, wondered if the guidelines would allow for proposed generation to have contracts signed should the economy turn around and power prices go up, or if they were limited to existing generation, and therefore diminish the ability to secure financing for new generation. **Commissioner Rowe** explained the guidelines had not yet been finalized and therefore, specifics could change but he was certain they would not be limited to existing generation. He worried, though, that the default obligation was scheduled to end at about the time more volatility in the Western wholesale market was forecast.

Closing by Sponsor:

SEN. COBB closed by saying this bill required the commission to become more involved up front but resulted in long-term benefits for the consumer.

ADJOURNMENT

Adjournment: 4:40 P.M.

SEN. ROYAL JOHNSON, Chairman

MARION MOOD, Secretary

RJ/MM

EXHIBIT (ens20aad)